

§ 1.1368-4

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from the sale or exchange of property, as appropriate. The remainder of the two distributions is treated as a dividend to the extent that it does not exceed S's earnings and profits. E and F must each report \$10 of dividend income for the February 1 distribution. For the September 1 distribution, E and F must each report \$5 of dividend income.

Example 9. Ordinary and redemption distributions in the same taxable year. (i) On January 1, 1995, Corporation S, an S corporation, has \$20 of earnings and profits and a balance in the AAA of \$10. S has two shareholders, G and H, each of whom owns 50 shares of S's stock. For 1995, S has taxable income of \$16, which increases the AAA to \$26 as of December 31, 1995 (before taking into account distributions made during 1995). On February 1, 1995, S distributes \$10 to each shareholder. On December 31, 1995, S redeems for \$13 all of shareholder G's stock in a redemption that is treated as a sale or exchange under section 302(a).

(ii) The sum of the ordinary distributions does not exceed S's AAA. Therefore, S must reduce the \$26 balance in the AAA by \$20 for the February 1 ordinary distribution. The portions of the distribution by which the AAA is reduced are treated by the shareholders as a return of capital or gain from the sale or exchange of property. S must adjust the remaining AAA, \$6, in an amount equal to the ratable share of the remaining AAA attributable to the redeemed stock, or \$3 (50%×\$6).

(iii) S also must adjust the earnings and profits of \$20 in an amount equal to the ratable share of the earnings and profits attributable to the redeemed stock. Therefore, S adjusts the earnings and profits by \$10 (50%×\$20), the ratable share of the earnings and profits attributable to the redeemed stock.

[T.D. 8508, 59 FR 22, Jan. 3, 1994; 59 FR 10675, Mar. 7, 1994, as amended by T.D. 8852, 64 FR 71650, Dec. 22, 1999]

§ 1.1368-4 Effective date and transition rule.

Except for §§ 1.1368-1(e)(2), 1.1368-2(a)(5), and 1.1368-3 *Example 2*, *Example 4*, and *Example 5*, §§ 1.1368-1, 1.1368-2, and 1.1368-3 apply to taxable years of the corporation beginning on or after January 1, 1994. Section 1.1368-1(e)(2), § 1.1368-2(a)(5), and § 1.1368-3 *Example 2*, *Example 4*, and *Example 5* apply only to taxable years of the corporation beginning on or after August 18, 1998. For taxable years beginning before January 1, 1994, and taxable years beginning on or after January 1, 1997, and before August 18, 1998, the treatment of distributions by an S corporation to its share-

holders must be determined in a reasonable manner, taking into account the statute and legislative history. Except with regard to the deemed dividend rule under § 1.1368-1(f)(3), § 1.1368-1(e)(2), § 1.1368-2(a)(5), and § 1.1368-3 *Example 2*, *Example 4*, and *Example 5*, return positions consistent with §§ 1.1368-1, 1.1368-2, and 1.1368-3 are reasonable for taxable years beginning before January 1, 1994. Return positions consistent with §§ 1.1368-1(e)(2), 1.1368-2(a)(5), and 1.1368-3 *Example 2*, *Example 4*, and *Example 5* are reasonable for taxable years beginning on or after January 1, 1997, and before August 18, 1998.

[T.D. 8852, 64 FR 71651, Dec. 22, 1999]

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This section lists the major paragraph headings for §§ 1.1374-1 through 1.1374-10.

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- (c) Section 1374 attributes.
- (d) Recognition period.
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§ 1.1374-4 Recognized built-in gain or loss.

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 - (1) Section 267(a)(2).
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